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Nos. ~~1088-1089~~

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

SECURITIES AND EXCHANGE COMMISSION,
Petitioner

v.

CHENERY CORPORATION, *et al*

SECURITIES AND EXCHANGE COMMISSION,
Petitioner

v.

FEDERAL WATER AND GAS CORPORATION

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR FEDERAL WATER AND GAS CORPORATION IN OPPOSITION

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April, 1946.

INDEX

CITATIONS

Cases:

Statutes:

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Opinions Below

The opinion of the Court of Appeals (R. 172-179) has not yet been officially reported. The findings and opinion of the Commission, which accompanied its order of February 7, 1945 (R. 128) are reported in S. E. C. Holding Company Act Release No. 5584.

Jurisdiction

The judgment of the Court of Appeals was entered February 4, 1946 (R. 180). The petition for writs of certiorari was filed on April 8, 1946 and served on April 10, 1946. The jurisdiction of this Court is invoked under Section 240a of the Judicial Code as amended, which is made applicable by Section 24(a) of the Public Utility Holding Company Act of 1935.

Question Presented

Did the Court below err in setting aside the order of the Securities and Exchange Commission entered on February 7, 1945 and remanding the causes to the Commission for further proceedings not inconsistent with the opinion of that Court?

Statute Involved

Relevant provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 838, 15 U. S. C., Secs. 79 et seq. are set forth in the Appendix to the Petition.

Statement

Section 7(d)(6) of the Public Utility Holding Company Act of 1935 authorizes the Commission to refuse to permit a declaration regarding the issue or sale of a security by a registered holding company to become effective if the Commission finds that "the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interest of investors or consumers."

Section 11(e) authorizes a registered holding company to submit to the Commission a plan for the purpose of enabling the company to comply with the provisions of sub-

section (b) and authorizes the Commission to make an order approving the plan if the Commission finds that the plan is "necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by the plan.". Section 11(e) further authorizes the Commission at the request of the company to apply to a United States District Court to enforce and carry out the terms of the plan and authorizes the Court to enforce the plan, if after hearing the Court approves the plan "as fair and equitable, and as appropriate to effectuate the provisions of Section 11".

Purporting to act under the authority granted to it by Sections 7 and 11 of the Public Utility Holding Company Act, the Commission on March 24, 1941 entered an order denying effectiveness to declarations which proposed to the Commission a merger under Section 59 of the Delaware Corporation Law between Federal Water Service Corporation, Utility Operators Company and Federal Water and Gas Corporation unless the proposed merger agreement was amended so as to discriminate against stock owned by officers or directors of Federal Water Service Corporation or Utility Operators Company and purchased by them after November 8, 1937 (8 S. E. C. 893).

The merger agreement was amended so as to meet the views of the Commission and, as amended, was approved by order entered September 24, 1941 (10 S. E. C. 200). It was consummated on October 31, 1941 pursuant to the votes of stockholders in accordance with Delaware Corporation Law, leaving the officers and directors affected by the discriminatory paragraph in the merger agreement with the right to review the order of the Commission (R. 121).

On review by the Court of Appeals for the District of Columbia, the order of the Commission of September 24,

1941 approving the discriminatory paragraph of the merger agreement was reversed and the cause remanded for further proceedings in conformity with the Court's opinion (*Chenery Corporation* v. *Securities and Exchange Commission*, 128 F. (2d) 303). On certiorari, this Court directed that the cause be remanded to the Commission for further action not inconsistent with its opinion (*Securities and Exchange Commission* v. *Chenery Corporation*, 318 U. S. 80).

Following the entry of the order of the Court of Appeals on the mandate of this Court (R. 117-118) Federal Water and Gas Corporation, the surviving corporation, filed with the Commission an application and declaration requesting that an appropriate order be entered permitting it to submit to its stockholders at a special meeting to be called for that purpose a proposed amendment to the merger agreement, the effect of which, if adopted by the stockholders, would be to eliminate the discriminatory paragraph in the merger agreement and permit the stockholders discriminated against to exchange their outstanding certificates of preferred stock of Federal Water Service Corporation for certificates of common stock of the surviving corporation and receive the dividends which they would have received if they had been accorded parity of treatment by the merger agreement. At the same time they moved the Commission that such proceedings be had as might be necessary to treat them on the same basis as other holders of preferred stock of Federal Water Service Corporation of the same class (R. 127). No additional testimony was taken on these applications. On February 7, 1945, the Commission denied the application of Federal Water and Gas Corporation for leave to amend the merger agreement on the ground that its order of September 24, 1941 should be reaffirmed.

Argument

In its opinion of March 24, 1941, the Commission said (8 S. E. C. 916-920):

> "* * * Corporate directors are fiduciaries—their powers are powers in trust (*Pepper* v. *Litton*, 308 U. S. 295). We hold further that in the process of formulation of a 'voluntary' reorganization plan, the management of a corporation occupies a fiduciary position toward all of the security holders to be affected, and that it is subjected to the same standards as other fiduciaries with respect to dealing with the property which is the subject matter of the trust. Of course, the management does not hold title to the securities, but its duty of fair dealing with the persons for whom it acts is as great as is that of a trustee who holds title to a *res* for the benefit of his beneficiaries. A trustee may not 'become the purchaser of the property which he represents or any portion of it though he has done so for a fair price without fraud at a public sale.' *Michoud* v. *Girod*, 4 How. 502, 557 (1846). Accordingly, honesty, full disclosure and purchase at a fair price do not take the case outside the rule. The need for an inflexible rule was recognized in *Michoud* v. *Girod*, *supra*:
>
> > 'Is it not better that the cause of the evil shall be prohibited, than that courts of equity shall be relied upon to apply the remedy in particular cases, by inquiring into all the circumstances of a case, whether there has or has not been fraud in fact?'
>
> * * *
>
> The result of these cases does not depend on dishonesty or unfair dealing, for it was conceded in the *Otis* case, *supra*, that the brokerage house which acted as committee had lost money in the transac-

tions, that it had acted in good faith, that the sellers of the bonds knew that the house was representing the bondholders, and that it had entered into the transactions 'for the accommodation' of its customers. Similar facts appeared in the *Mountain States* case. * * *

We think that the authorities heretofore cited are fully applicable to the position of the management of a corporation trading in the securities which will be affected by a voluntary plan of reorganization upon which the management is working. We, no more than a court of equity, should undertake to decide case by case whether the management's trading has in fact operated to the detriment of the persons whom it represents. * * *

Similarly, deciding whether the terms of issuance of the new common stock are fair and equitable or are detrimental to the interests of investors, we must find that they are unfair, inequitable, and detrimental, so long as the preferred stock purchased by the management at low prices is to be permitted to share on a parity with other preferred stock. * * *"

In its opinion of February 7, 1945, the Commission said (R. 163-165):

"As we have already indicated, the personal integrity of these particular interveners is not a question at issue in this case. For obvious reasons we do not conceive it our function to try to guess whether a reorganization manager, faced with a choice of conducting the reorganization for the accomplishment of his own objectives or for the benefit of security holders generally, is the kind of man who would be likely to take one course and not the other. What we say is that when reorganization

managers have undertaken a program of acquiring their company's securities for their own account, in contemplation of or during the reorganization proceedings under their charge, they have placed themselves in a position where they are peculiarly susceptible to temption to conduct the reorganization for personal gain rather than the public good; the program of making advantageous purchases of stock could have had an important influence—even though subconsciously—upon great numbers of business decisions all along the way. * * * What we mean, therefore—and we cannot emphasize this too strongly—is that concepts of 'honesty, full disclosure and purchase at a fair price,' traditionally applied to dealings in normal course between corporate managers and stockholders, cannot be the controlling tests in the decision of this case. * * * Since the more subtle, though powerful, forms of such conduct defies specific proof and since the application of a subjective standard of good faith would in any event be inappropriate here, we must foreclose an inquiry into the motives and intentions of reorganization managers who have engaged in so potentially harmful a practice as seeking to profit by a program of security purchases during the course of a reorganization in which they take so important a role. * * * The problem before us is, therefore, one of temptations combined with powers of accomplishment. Since the achieving of personal gain through the use of fiduciary power is unfair, we believe the incentive to misuse such power must be removed so that the potentialities of harm to investors and the public will to that extent be eliminated."

It is apparent that there is no substantial difference between these two decisions. In both of them the Commission sought to decide the case before it by giving retroactive

effect to a new policy as to purchases of stock by officers and directors.

This Court's former opinion was rendered on February 1, 1943. Federal Water and Gas Corporation's application for leave to amend the merger agreement was filed on April 7, 1943. The Commission's decision was rendered February 7, 1945, approximately two years after this Court's decision. The granting of certiorari could only result in further delay.

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